

Zoe's Kitchen, Inc.  
Form 10-Q  
November 14, 2016

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended October 3, 2016

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File No. 001-36411

ZOE'S KITCHEN, INC.

(Exact name of registrant as specified in its charter)

Delaware 51-0653504  
(State or other jurisdiction of (IRS Employer  
incorporation or organization) Identification No.)

5760 State Highway 121, Suite 250 75024  
Plano, Texas  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code:  
(214) 436-8765

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

On November 14, 2016, there were 19,460,467 shares of common stock outstanding.

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## Part I - Financial Information

## Item 1. Financial Statements

## Zoe's Kitchen, Inc. and Subsidiaries

## Unaudited Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)

	October 3, 2016	December 28, 2015
Assets		
Current Assets:		
Cash and cash equivalents	\$9,502	\$ 19,131
Trade accounts receivable, net of allowance for doubtful accounts	1,368	853
Other accounts receivable	3,802	1,305
Inventory	2,061	1,660
Prepaid expenses and other	3,667	1,526
Assets held for sale	—	2,128
Total current assets	20,400	26,603
Property and equipment, net	158,861	131,819
Goodwill	29,528	29,528
Intangibles, net	8,328	9,568
Other long-term assets, net	492	476
Total long-term assets	197,209	171,391
Total assets	\$217,609	\$ 197,994
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$10,817	\$ 6,418
Accrued expenses and other	14,942	12,918
Total current liabilities	25,759	19,336
Long-term liabilities:		
Deemed landlord financing	27,697	28,415
Deferred rent	26,974	20,264
Deferred income taxes	6,957	4,743
Other long-term liabilities, net	210	280
Total long-term liabilities	61,838	53,702
Total liabilities	87,597	73,038
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Common stock: \$0.01 par value, 135,000,000 shares authorized as of October 3, 2016 and December 28, 2015; 19,460,467 and 19,385,645 issued and outstanding as of October 3, 2016 and December 28, 2015, respectively.	\$195	\$ 194
Additional paid-in capital	148,027	145,276
Accumulated deficit	(18,210 )	(20,514 )
Total stockholders' equity	130,012	124,956
Total liabilities and stockholders' equity	\$217,609	\$ 197,994

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.



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Zoe's Kitchen, Inc. and Subsidiaries  
 Unaudited Condensed Consolidated Statements of Operations  
 (in thousands, except share and per share data)

	Twelve Weeks Ended		Forty Weeks Ended	
	October 3, 2016	October 5, 2015	October 3, 2016	October 5, 2015
Revenue:				
Restaurant sales	\$67,245	\$ 56,333	\$213,815	\$ 173,706
Royalty fees	51	51	165	160
Total revenue	67,296	56,384	213,980	173,866
Operating expenses:				
Restaurant operating costs (excluding depreciation and amortization):				
Cost of sales	20,780	17,729	64,764	54,716
Labor	19,503	15,861	61,612	48,686
Store operating expenses	14,086	10,589	42,534	32,890
General and administrative expenses	6,313	6,394	23,028	19,897
Depreciation	3,489	2,761	10,773	8,540
Amortization	367	375	1,240	1,262
Pre-opening costs	614	689	1,906	2,174
Casualty loss	—	351	—	351
Loss from disposal of equipment	91	50	428	197
Total operating expenses	65,243	54,799	206,285	168,713
Income from operations	2,053	1,585	7,695	5,153
Other income and expenses:				
Interest expense, net	916	767	2,899	2,449
Other income	(20 )	(20 )	(67 )	(51 )
Total other income and expenses	896	747	2,832	2,398
Income before provision for income taxes	1,157	838	4,863	2,755
Provision for income taxes	1,450	3,094	2,559	4,199
Net income (loss)	\$(293 )	\$(2,256 )	\$2,304	\$(1,444 )
Earnings (loss) per share:				
Basic	\$(0.02 )	\$(0.12 )	\$0.12	\$(0.07 )
Diluted	\$(0.02 )	\$(0.12 )	\$0.12	\$(0.07 )
Weighted average shares of common stock outstanding:				
Basic	19,458,921	19,379,907	19,426,868	19,333,138
Diluted	19,458,921	19,379,907	19,597,894	19,333,138

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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## Zoe's Kitchen, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows  
(in thousands)

	Forty Weeks Ended	
	October 30, 2016	October 5, 2015
Cash flows from operating activities:		
Net income (loss)	\$2,304	\$(1,444 )
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation	10,773	8,540
Amortization of intangible assets	1,240	1,262
Equity-based compensation	1,669	877
Deferred income taxes	2,451	4,116
Amortization of loan costs	17	15
Bad debt expense	43	5
Casualty loss	—	351
Loss from disposal of equipment	428	197
Accretion of deemed landlord financing	243	201
Changes in operating assets and liabilities:		
Trade accounts receivable	(558 )	(466 )
Other accounts receivable	(2,497 )	(559 )
Inventory	(401 )	(332 )
Prepaid expenses and other	(2,166 )	(1,207 )
Accounts payable	1,633	714
Accrued expenses and other	108	2,167
Deferred rent	6,769	5,512
Net cash provided by operating activities	22,056	19,949
Cash flows from investing activities:		
Purchase of property and equipment	(35,070)	(30,705 )
Proceeds from sale-leaseback transactions	2,089	—
Proceeds from sale of property and equipment	76	108
Net cash used in investing activities	(32,905)	(30,597 )
Cash flows from financing activities:		
Proceeds from deemed landlord financing	138	409
Proceeds from exercise of stock options	1,082	1,339
Payments of loan acquisition fees	—	(97 )
Net cash provided by financing activities	1,220	1,651
Net change in cash and cash equivalents	(9,629 )	(8,997 )
Cash and cash equivalents:		
Beginning of period	19,131	29,390
End of period	\$9,502	\$20,393
Supplemental disclosure of cash flow information:		
Cash paid for interest related to deemed landlord financing	2,897	2,450
Non-cash deemed landlord financing	(1,100)	2,750
Change in accrued purchases of property and equipment	4,396	637

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.



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Zoe's Kitchen, Inc. and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

1. Nature of Operations and Basis of Presentation

Nature of Operations

Zoe's Kitchen, Inc. (the "Company", "Zoës", "we" or "us") primarily develops and operates fast-casual restaurants serving a distinct menu of freshly prepared Mediterranean-inspired dishes. As of October 3, 2016, we operated 194 Company-owned restaurants and three franchise restaurants in 20 states across the United States. We have determined that we have one operating and reportable segment. All of our revenues are derived in the United States. All of our assets are located in the United States.

Interim Financial Statements

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles and practices of the United States of America ("GAAP") for interim financial information. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair statement of the results for interim periods have been included.

Certain information and footnote disclosures normally included in audited consolidated financial statements presented in accordance with GAAP have been omitted pursuant to rules and regulations of the Securities and Exchange Commission (the "SEC"). Due to the seasonality of our business, results for any interim financial period are not necessarily indicative of the results that may be achieved for a full fiscal year. In addition, quarterly results of operations may be impacted by the timing and amount of sales and costs associated with the opening of new restaurants. These interim unaudited condensed consolidated financial statements do not represent complete financial statements and should be read in conjunction with our annual financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2015 (the "2015 Form 10-K"). While the condensed consolidated balance sheet data as of December 28, 2015 was derived from audited financial statements, it does not include all disclosures required by GAAP.

Comprehensive Income (Loss)

Comprehensive income (loss) is the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income (loss) is the same as net income (loss) for all periods presented. Therefore, a separate statement of comprehensive income (loss) is not included in the accompanying condensed consolidated financial statements.

Principles of Consolidation

The unaudited condensed consolidated financial statements include the accounts of Zoe's Kitchen, Inc. and its wholly owned subsidiaries, Zoe's Kitchen USA, LLC and Soho Franchising, LLC. All intercompany accounts and transactions have been eliminated in consolidation. The unaudited condensed consolidated financial statements presented herein reflect our financial position, results of operations and cash flows in conformity with GAAP.

Fiscal Year

We operate on a 52- or 53-week fiscal year that ends on the last Monday of the calendar year. Fiscal years ended December 26, 2016 and December 28, 2015 consist of 52 weeks. Our first fiscal quarter consists of 16 weeks, and each of our second, third and fourth fiscal quarters consists of 12 weeks, except for a 53-week year when the fourth quarter has 13 weeks.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions, such as valuation of long-lived, definite and indefinite-lived assets, estimated useful lives of assets, the reasonably assured lease terms of operating leases, the construction costs of leases where the Company is considered the owner during and after the construction period, allowance for doubtful accounts, the fair value and forfeiture rates related to equity-based compensation, the calculation of





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self-insurance reserves, and deferred tax valuation allowances, that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Recently Issued Accounting Standards

In August 2016, the Financial Accounting Standard Board ("FASB") issued Accounting Standard Update ("ASU") No. 2016-15, "Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments," which provides specific guidance regarding presentation and classification on a variety of cash payments and receipts. Among the issues addressed is the classification of proceeds from the settlement of insurance claims. This pronouncement is effective for reporting periods beginning after December 15, 2017 and early adoption is permitted. We do not expect the adoption of ASU 2016-15 to have a material impact on our financial position or results of operations.

In March 2016, the FASB issued ASU No. 2016-09, "Compensation – Stock Compensation (Topic 718)." The pronouncement was issued to simplify the accounting for share-based payment transactions, including income tax consequences, the classification of awards as either equity or liabilities, and the classification on the statement of cash flows. This pronouncement is effective for reporting periods beginning after December 15, 2016. We are currently evaluating the impact of the adoption of ASU 2016-09 on our consolidated financial position or results of operations.

In March 2016, the FASB issued ASU No. 2016-04, "Liabilities - Extinguishments of Liabilities (Subtopic 405-20)", which amends subtopic 405-20 to provide a scope exception that requires breakage for prepaid stored-value product liabilities to be accounted for consistent with the breakage guidance in Topic 606. The amendment is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years. We do not expect the adoption of ASU 2016-04 to have a material impact on our financial position or results of operations.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)," which requires entities to recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements.

Previous lease accounting did not require certain lease types to be recognized on the balance sheet. This update is an amendment to the codification and is effective for fiscal years beginning after December 15, 2018 including interim periods within those fiscal years applied using a modified retrospective approach. Early adoption is permitted. We are currently evaluating the impact of the adoption of ASU 2016-02 on our consolidated financial position or results of operations, but expect that it will result in a significant increase in our long-term assets and liabilities given we have a significant number of leases.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers." This update was issued to replace the current revenue recognition guidance, creating a more comprehensive revenue model. In August 2015, the FASB issued ASU 2015-14 to defer the effective date for adoption. The update is now effective for reporting periods beginning after December 15, 2017. In March 2016, April 2016 and May 2016, the FASB also issued ASU 2016-08, ASU 2016-10 and ASU 2016-12, respectively, to further clarify performance obligations and licensing implementation guidance and other general topics. We are currently evaluating the impact of the adoption of ASU 2014-09 on our consolidated financial position or results of operations.

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## 2. Supplemental Information

Property and equipment, net consisted of the following (in thousands):

	October 3, December 28,	
	2016	2015
Land	\$822	\$ —
Buildings under deemed landlord financing	22,000	23,100
Leasehold improvements	119,228	96,276
Machinery and equipment	30,637	23,894
Furniture and fixtures	6,259	5,150
Automobiles	4,019	3,985
Computer equipment	9,159	6,421
Construction in progress	10,179	6,805
Property and equipment, gross	202,303	165,631
Less: Accumulated depreciation	(43,442 )	(33,812 )
Total Property and equipment, net	\$158,861	\$131,819

Accrued expenses and other consisted of the following (in thousands):

	October 3, December 28,	
	2016	2015
Accrued payroll and payroll taxes	\$ 4,784	\$ 5,365
Accrued capital purchases	3,034	1,403
Sales tax payable	1,874	1,274
Gift card payable	559	1,121
Other accrued expenses	4,691	3,755
Total Accrued expenses and other	\$ 14,942	\$ 12,918

## 3. Fair Value Measurements

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable and all other current liabilities approximate fair values due to the short maturities of these instruments.

## 4. Bank Line of Credit and Term Loan

On February 6, 2015, we entered into a credit facility with Wells Fargo Bank, National Association (the "2015 Credit Facility"). The 2015 Credit Facility consists of a revolving loan commitment in the aggregate amount of \$20.0 million, together with an incremental revolving credit commitment up to an aggregate amount of \$30.0 million. The 2015 Credit Facility has a five year term and matures on February 6, 2020. As of October 3, 2016, we had no indebtedness under the 2015 Credit Facility.

Revolving credit loans under the 2015 Credit Facility bear interest, at the Company's election, at either the base rate plus an applicable margin, or LIBOR plus an applicable margin. The base rate consists of the highest of the prime rate, the federal funds rate plus 0.5% and LIBOR plus 1.0%. The applicable margin and associated loan commitment fee consists of two pricing levels based on the Company's consolidated total debt ratio. If this debt ratio is greater than or equal to 2.50 to 1, then the unused commitment fee is 0.15% per annum, and the applicable margin is LIBOR plus 1.5% or the base rate plus 0.5%. If this debt ratio is less than 2.50 to 1, then the unused commitment fee is 0.125% per annum and the applicable margin is LIBOR plus 1.0% or the base rate.

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The 2015 Credit Facility includes specific financial covenants such as a leverage ratio and an interest coverage ratio. We are also subject to other customary covenants, including limitations on additional borrowings, dividend payments and acquisitions. As of October 3, 2016, we were in compliance with these financial and other customary covenants.

### 5. Equity-based Compensation

In connection with our initial public offering in April 2014 (the "IPO"), we adopted the 2014 Omnibus Incentive Plan (the "2014 Incentive Plan"), which provides for grants of stock options, stock appreciation rights, restricted stock, other stock-based awards and other cash-based awards available to directors, officers and other employees of us and our subsidiaries, as well as others performing consulting or advisory services to us. The number of shares of common stock available for issuance under the 2014 Incentive Plan may not exceed 1,905,799.

The following table summarizes our stock option activity:

	Stock Options	Weighted Average Exercise Price
Outstanding as of December 28, 2015	712,165	\$ 25.38
Granted	129,215	27.42
Exercised	(70,190 )	15.42
Forfeited	(48,590 )	29.25
Expired	(9,796 )	29.24
Outstanding as of October 3, 2016	712,804	\$ 26.41

There were 250,000 stock options granted that vested immediately upon completion of the IPO. All other options vest in four equal annual installments following the date of the grant with a contractual term of 10 years.

The following table reflects the weighted-average assumptions utilized in the Black-Scholes option-pricing model to value the stock options granted:

	Forty Weeks Ended October 3, 2016
Expected volatility <sup>(1)</sup>	31.8%
Risk-free rate of return	1.35%
Expected life (in years) <sup>(2)</sup>	6.3
Dividend yield	0%
Weighted-average fair value per share at date of grant	\$9.29

(1) Expected volatility was based on competitors within the industry.

(2) Expected life was calculated using the simplified method, which is an average of the contractual term of the option and its ordinary vesting period, as we do not have sufficient historical data for determining the expected term of our stock option awards.

The following table summarizes our restricted stock unit activity:

	Restricted Stock Units	Weighted Average Grant Date Fair Value
Non-vested at December 28, 2015	11,679	\$ 27.12
Granted	78,736	28.35
Vested	(4,632 )	25.18
Forfeited	(4,376 )	27.42
Non-vested at October 3, 2016	81,407	28.40



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The fair value of the non-vested restricted stock units is based on the closing price on the date of grant. All of our outstanding restricted stock units vest in three equal annual installments following the date of the grant.

We recognized equity-based compensation as a component of general and administrative expenses of \$0.5 million and \$0.3 million during the twelve weeks ended October 3, 2016 and October 5, 2015, respectively, and \$1.7 million and \$0.9 million during the forty weeks ended October 3, 2016 and October 5, 2015, respectively. As of October 3, 2016, total unrecognized compensation expense related to non-vested stock awards, including an estimate for pre-vesting forfeitures, was \$5.4 million, which is expected to be recognized over a weighted-average period of 2.5 years.

## 6. Earnings Per Share

Basic net income (loss) per share is calculated by dividing net income (loss) by the weighted average shares outstanding during the period, without consideration of common stock equivalents. Diluted net income (loss) per share is calculated by adjusting weighted average shares outstanding for the dilutive effect of common stock equivalents outstanding for the period, determined using the treasury-stock method.

The following table presents the computation of basic and diluted net income (loss) per share for the period indicated:

	Twelve Weeks Ended October 3, 2016		Forty Weeks Ended October 5, 2015	
Net income (loss) (in thousands):	\$ (293 )	\$ (2,256 )	\$ 2,304	\$ (1,444 )
Shares:				
Basic weighted average shares outstanding	19,458,921	19,379,907	19,426,868	19,333,138
Diluted weighted average shares outstanding	19,458,921	19,379,907	19,597,899	19,333,138
Earnings (loss) per share:				
Basic EPS	\$(0.02)	\$(0.12 )	\$0.12	\$(0.07 )
Diluted EPS	\$(0.02)	\$(0.12 )	\$0.12	\$(0.07 )

During the twelve weeks ended October 3, 2016, there were 591,546 stock options and 26,055 restricted stock units excluded from the diluted earnings per share calculation because their inclusion would have been anti-dilutive. During the twelve weeks ended October 5, 2015, there were 493,039 stock options and 4,619 restricted stock units excluded from the diluted earnings per share calculation because their inclusion would have been anti dilutive.

During the forty weeks ended October 3, 2016, there were 411,001 stock options and 2,487 restricted stock units excluded from the diluted earnings per share calculation because their inclusion would have been anti-dilutive. During the forty weeks ended October 5, 2015, there were 482,435 stock options and 4,302 restricted stock units excluded from the diluted earnings per share calculation because their inclusion would have been anti-dilutive.

## 7. Income Taxes

Provision for income taxes was \$1.5 million and \$3.1 million for the twelve weeks ended October 3, 2016 and October 5, 2015, respectively, and \$2.6 million and \$4.2 million for the forty weeks ended October 3, 2016 and October 5, 2015, respectively. The effective tax rate was 52% and 152% for the forty weeks ended October 3, 2016 and October 5, 2015, respectively. Our tax expense typically remains relatively constant as it primarily reflects the accrual of income tax expense related to a valuation allowance in connection with the tax amortization of the Company's goodwill that was not available to offset existing deferred tax assets. Due to the uncertain timing of the reversal of this temporary difference, it cannot be considered as a source of future taxable income for purposes of determining a valuation allowance; therefore, the deferred tax liability cannot offset deferred tax assets. Our quarterly provision for income taxes is measured using an annual estimated effective tax rate for the full year applied

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to period earnings. The comparison of our effective tax rate between periods is significantly impacted by the level of pre-tax income earned and projected for the year. Our historical fourth quarter results in negative pretax income, creating significant fluctuations in income tax expense and the resulting effective tax rate quarter over quarter and year over year.

We continue to monitor and evaluate the rationale for recording a full valuation allowance for the net amount of the deferred tax assets which are in excess of the indefinite-lived intangible asset deferred tax liabilities. We intend to continue maintaining a full valuation allowance on these net deferred tax assets until there is sufficient evidence to support the reversal of all or some portion of these allowances. However, given our current earnings and anticipated future earnings, we believe there is a reasonable possibility that within the foreseeable future sufficient positive evidence may become available to allow us to reach a conclusion that a significant portion of the valuation allowance will no longer be needed. Release of the valuation allowance would result in the recognition of certain deferred tax assets and a decrease to income tax expense for the period that the release is recorded. However, the exact timing and amount of the valuation allowance release are subject to change on the basis of the level of profitability that we are able to achieve.

8. Commitments and Contingencies

Franchise Agreement

Our Kentucky franchise agreement, which requires the franchisee to remit continuing royalty fees at a specified percentage of the franchisee's gross sales revenue, provides that we as franchisor, or our authorized representative, will: (a) provide franchisee with written schedules of all foods, food products, beverages, and other items for sale, and the furniture, fixtures, supplies and equipment necessary and required for the operation of the restaurant; (b) provide franchisee with a list of approved suppliers for the products and services necessary and required for the restaurant; (c) upon the reasonable written request of franchisee, render reasonable advisory services by telephone or in writing pertaining to the operation of the restaurant; (d) provide franchisee with a sample of the standard Zoës Kitchen menu, and any modifications to the menu; (e) loan franchisee a copy of the system's operating manual and any supplements to the manual that may be published by us; and (f) provide franchisee the opportunity to participate in group purchasing programs that we may use, develop, sponsor or provide on terms and conditions determined solely by us. In addition, as a condition to the commencement of business by the franchisee, the franchisee must attend and successfully complete our training program.

Litigation

On October 31, 2014, Forsyth Consulting, Inc. ("Forsyth"), a former music vendor for the Company, filed a complaint against the Company in the Circuit Court of Jefferson County, Alabama alleging breach of contract with respect to its prior music service contract. We have removed the action to federal court and, on December 19, 2014, we filed a counterclaim in the United States District Court for the Northern District of Alabama, alleging breach of contract and tortious interference with business relations claims against Forsyth. We do not anticipate the results of this proceeding to have a material effect on our results of operations.

We are currently involved in various claims and legal actions that arise in the ordinary course of our business, including claims resulting from employment related matters. None of these claims, most of which are covered by insurance, has had a material effect on us. As of the date of this report, other than as set forth above, we are not party to any material pending legal proceedings and are not aware of any claims that could have a material adverse effect on our business, financial condition, results of operations or cash flows. However, a significant increase in the number of these claims or an increase in amounts owing under successful claims could materially and adversely affect our business, financial condition, results of operations or cash flows.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion summarizes the significant factors affecting our consolidated operating results, financial condition, liquidity and cash flows as of and for the periods presented below. The following discussion and analysis should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and related notes in Item 1 and with the audited consolidated financial statements and the related notes included in our 2015 Form 10-K.

In addition to historical information, this discussion and analysis contains forward-looking statements based on current expectations that involve risks, uncertainties and assumptions, such as our plans, objectives, expectations, and intentions set forth under the sections entitled "Risk Factors" and "Forward-Looking Statements" as filed in our 2015 Form 10-K.

Overview

Zoës Kitchen is a fast growing, fast-casual restaurant concept serving a distinct menu of fresh, wholesome, Mediterranean-inspired dishes delivered with Southern hospitality. Founded in 1995 by Zoë and Marcus Cassimus in Birmingham, Alabama, Zoës Kitchen is a natural extension of Zoë Cassimus' lifetime passion for cooking Mediterranean meals for family and friends. Since opening our first restaurant, we have never wavered from our commitment to make our food fresh daily and to serve our customers in a warm and welcoming environment. We believe our brand delivers on our customers' desire for freshly-prepared food, convenient, unique and high-quality experiences and their commitment to family, friends and enjoying every moment.

Growth Strategies and Outlook

We plan to execute the following strategies to continue to enhance our brand awareness and grow our revenue and increase profitability:

- grow our restaurant base;
- increase our comparable restaurant sales; and
- improve our margins and leverage our infrastructure.

We have expanded our restaurant base from 21 restaurants in seven states in 2008 to 194 Company-owned restaurants and three franchise restaurants in 20 states as of October 3, 2016. We opened 31 Company-owned restaurants during the forty weeks ended October 3, 2016 and reopened the restaurant in South Carolina damaged by a hurricane last year. We plan to open 37-38 restaurants in 2016, including the restaurants opened in the forty weeks ended October 3, 2016. In fiscal year 2016 we have opened 35 restaurants as of November 14, 2016 and reopened the restaurant in South Carolina damaged by a hurricane last year. We expect to double our restaurant base in the next four years. To increase comparable restaurant sales, we plan to heighten brand awareness to drive new customer traffic, increase existing customer frequency and grow our catering business. With our strong brand positioning and developed infrastructure capable of supporting a restaurant base that is greater than our existing footprint, we believe we are well positioned for future growth. Additionally, we believe we have an opportunity to optimize costs and increase profitability as we benefit from economies of scale.

Key Measures We Use to Evaluate Our Performance

In assessing the performance of our business, we consider a variety of performance and financial measures. The key measures used by our management for determining how our business is performing are restaurant sales, comparable restaurant sales growth, restaurant contribution, number of new restaurant openings, EBITDA and Adjusted EBITDA.

Restaurant Sales

Restaurant sales represents sales of food and beverages in Company-owned restaurants. Several factors affect our restaurant sales in any given period, including the number of restaurants in operation and per restaurant sales.





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### Comparable Restaurant Sales Growth

Comparable restaurant sales refers to year-over-year sales comparisons for the comparable Company-owned restaurant base. We define the comparable restaurant base to include those restaurants open for 18 fiscal periods or longer. Each fiscal period consists of 28 days. As of October 3, 2016 and October 5, 2015, there were 143 and 111 restaurants, respectively, in our comparable Company-owned restaurant base. This measure highlights performance of existing restaurants, as the impact of new Company-owned restaurant openings is excluded.

Comparable restaurant sales growth is generated by an increase in transactions or changes in per transaction spend. Per transaction spend can be influenced by changes in menu prices and/or the mix and number of items sold per check.

Measuring our comparable restaurant sales allows us to evaluate the performance of our existing restaurant base.

Various factors impact comparable restaurant sales, including:

- consumer recognition of our brand and our ability to respond to changing consumer preferences;
- overall economic trends, particularly those related to consumer spending;
- our ability to operate restaurants effectively and efficiently to meet consumer expectations;
- pricing;
- customer demand;
- per-transaction spend and average check amount;
- marketing and promotional efforts;
- local competition;
- trade area dynamics;
- introduction of new menu items; and
- opening of new restaurants in the vicinity of existing locations.

Consistent with common industry practice, we present comparable restaurant sales on a fiscal year basis that aligns current year sales weeks with comparable periods in the prior year, regardless of whether they belong to the same calendar period or not. Since opening new Company-owned restaurants will be a significant component of our revenue growth, comparable restaurant sales is only one measure of how we evaluate our performance.

### Restaurant Contribution

Restaurant contribution is defined as restaurant sales less restaurant operating costs, which are cost of sales, labor, and store operating expenses. Restaurant contribution margin is restaurant contribution as a percentage of restaurant sales.

### Number of New Restaurant Openings

The number of Company-owned restaurant openings reflects the number of restaurants opened during a particular reporting period. Before we open new Company-owned restaurants, we incur pre-opening costs. Some of our restaurants open with an initial start-up period of higher than normal sales volumes, which subsequently decrease to stabilized levels. Typically, our new restaurants have stabilized sales after approximately 12 to 24 weeks of operation, at which time the restaurant's sales typically begin to grow on a consistent basis. In new markets, the length of time before average sales for new restaurants stabilize is less predictable and can be longer as a result of our limited knowledge of these markets and consumers' limited awareness of our brand. New restaurants may not be profitable, and their sales performance may not follow historical patterns. The number and timing of restaurant openings has had, and is expected to continue to have, an impact on our results of operations.

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The following table shows the growth in our Company-owned and franchise restaurant base:

	Twelve Weeks Ended October 3, 2016		Forty Weeks Ended October 3, 2016	
	October 5, 2015	October 3, 2015	October 5, 2015	October 3, 2015
<b>Company-owned Restaurant Base</b>				
Beginning of period	183	148	163	129
Openings	11	10	31	29
Restaurants at end of period	194	158	194	158
<b>Franchise Restaurant Base</b>				
Beginning of period	3	3	3	3
Restaurants at end of period	3	3	3	3
Total restaurants	197	161	197	161

**Key Financial Definitions**

**Restaurant sales.** Restaurant sales represent sales of food and beverages in Company-owned restaurants, net of promotional allowances and employee meals. Restaurant sales in a given period are directly impacted by the number of operating weeks in the period, the number of restaurants we operate and comparable restaurant sales growth.

**Royalty fees.** Royalty fees represent royalty income from the three franchised restaurants.

**Cost of sales.** Cost of sales consists primarily of food, beverage and packaging costs. The components of cost of sales are variable in nature, change with sales volume and are influenced by menu mix and subject to increases or decreases based on fluctuations in commodity costs.

**Labor.** Labor includes all restaurant-level management and hourly labor costs, including salaries, wages, benefits and bonuses, payroll taxes and other indirect labor costs.

**Store operating expenses.** Store operating expenses include all other restaurant-level operating expenses, such as supplies, utilities, repairs and maintenance, travel costs, credit card fees, recruiting, delivery service, restaurant-level marketing costs, security and occupancy expenses.

**General and administrative expenses.** General and administrative expenses include expenses associated with corporate and regional functions that support the development and operations of restaurants, including compensation and benefits, travel expenses, stock compensation costs, legal and professional fees, information systems, corporate office rent and other related corporate costs.

**Depreciation.** Depreciation consists of depreciation of fixed assets, including equipment and capitalized leasehold improvements.

**Amortization.** Amortization consists of amortization of certain intangible assets including franchise agreements, trademarks, reacquired rights and favorable leases.

**Pre-opening costs.** Pre-opening costs consist of expenses incurred prior to opening a new restaurant and are made up primarily of manager salaries, relocation costs, supplies, recruiting expenses, employee payroll and training costs.

Pre-opening costs also include occupancy costs recorded during the period between date of possession and the restaurant's opening date.

**Casualty loss.** Casualty loss consists of the non-cash loss recognized on the write-off of long-lived assets.

**Loss from disposal of equipment.** Loss from disposal of equipment is composed of the loss on disposal of assets related to retirements and replacements of leasehold improvements or equipment. These losses are related to normal disposals in the ordinary course of business, along with disposals related to selected restaurant remodeling activities.

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Interest expense, net. Interest expense includes cash and imputed non-cash charges related to our deemed landlord financing, non-cash charges related to our residual value obligations, amortization of debt issue costs as well as cash payments and accrued charges related to our 2015 Credit Facility.

Provision for income taxes. Provision for income taxes represents federal, state and local current and deferred income tax expense.

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## Consolidated Results of Operations

The following table summarizes key components of our results of operations for the periods indicated as a percentage of our total revenue, except for the components of restaurant operating costs, which are expressed as a percentage of restaurant sales.

	Twelve Weeks Ended		Forty Weeks Ended			
	October 3, 2016	October 5, 2015	October 3, 2016	October 5, 2016	October 5, 2015	
Revenue:						
Restaurant sales	99.9 %	99.9 %	99.9 %	99.9 %	99.9 %	
Royalty fees	0.1 %	0.1 %	0.1 %	0.1 %	0.1 %	
Total revenue	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %	
Operating expenses:						
Restaurant operating costs (excluding depreciation and amortization) <sup>(1)</sup> :						
Cost of sales	30.9 %	31.5 %	30.3 %	31.5 %	31.5 %	
Labor	29.0 %	28.2 %	28.8 %	28.0 %	28.0 %	
Store operating expenses	20.9 %	18.8 %	19.9 %	18.9 %	18.9 %	
General and administrative expenses	9.4 %	11.3 %	10.8 %	11.4 %	11.4 %	
Depreciation	5.2 %	4.9 %	5.0 %	4.9 %	4.9 %	
Amortization	0.5 %	0.7 %	0.6 %	0.7 %	0.7 %	
Pre-opening costs	0.9 %	1.2 %	0.9 %	1.3 %	1.3 %	
Casualty loss	—	0.6 %	—	0.2 %	0.2 %	
Loss from disposal of equipment	0.1 %	0.1 %	0.2 %	0.1 %	0.1 %	
Total operating expenses	96.9 %	97.2 %	96.4 %	97.0 %	97.0 %	
Income from operations	3.1 %	2.8 %	3.6 %	3.0 %	3.0 %	
Other income and expenses:						
Interest expense, net	1.4 %	1.4 %	1.4 %	1.4 %	1.4 %	
Other income	(0.0) %	(0.0) %	(0.0) %	(0.0) %	(0.0) %	
Total other income and expenses	1.3 %	1.3 %	1.3 %	1.4 %	1.4 %	
Income before provision for income taxes	1.7 %	1.5 %	2.3 %	1.6 %	1.6 %	
Provision for income taxes	2.2 %	5.5 %	1.2 %	2.4 %	2.4 %	
Net income (loss)	(0.4) %	(4.0) %	1.1 %	(0.8) %	(0.8) %	

(1) As a percentage of restaurant sales.

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Twelve Weeks Ended October 3, 2016 compared to Twelve Weeks Ended October 5, 2015

The following table presents selected consolidated comparative results of operations from our unaudited condensed consolidated financial statements for the twelve weeks ended October 3, 2016 compared to the twelve weeks ended October 5, 2015.

	Twelve Weeks Ended				
	October 3, 2016	October 5, 2015	Increase / (Decrease)		
			Dollars	Percentage	
(Dollars in thousands)					
Consolidated Statement of Operations Data:					
Revenue					
Restaurant sales	\$67,245	\$56,333	\$10,912	19.4	%
Royalty fees	51	51	—	—	%
Total revenue	67,296	56,384	10,912	19.4	%
Operating expenses:					
Restaurant operating costs (excluding depreciation and amortization):					
Cost of sales	20,780	17,729	3,051	17.2	%
Labor	19,503	15,861	3,642	23.0	%
Store operating expenses	14,086	10,589	3,497	33.0	%
General and administrative expenses	6,313	6,394	(81)	(1.3)	%
Depreciation	3,489	2,761	728	26.4	%
Amortization	367	375	(8)	(2.1)	%
Pre-opening costs	614	689	(75)	(10.9)	%
Casualty loss	—	351	(351)	(100.0)	%
Loss from disposal of equipment	91	50	41	82.0	%
Total operating expenses	65,243	54,799	10,444	19.1	%
Income from operations	2,053	1,585	468	29.5	%
Other expenses					
Interest expense, net	916	767	149	19.4	%
Other Income	(20)	(20)	—	—	%
Total other expenses	896	747	149	19.9	%
Income before provision for income taxes	1,157	838	319	38.1	%
Provision for income taxes	1,450	3,094	(1,644)	(53.1)	%
Net income (loss)	\$(293)	\$(2,256)	\$1,963	87.0	%

Restaurant sales. The following table summarizes the growth in restaurant sales from the twelve weeks ended October 5, 2015 to the twelve weeks ended October 3, 2016 (dollars in thousands):

	Net Sales
Restaurant sales for twelve weeks ended October 5, 2015	\$56,333
Incremental restaurant sales increase due to:	
Comparable restaurant sales	1,234
Restaurants not in comparable restaurant base	9,678
Restaurant sales for the twelve weeks ended October 3, 2016	\$67,245

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Restaurant sales increased by \$10.9 million, or 19.4%, in the twelve weeks ended October 3, 2016 compared to the twelve weeks ended October 5, 2015. Restaurants not in the comparable restaurant base and other sales accounted for \$9.7 million of this increase. The balance of the growth was due to an increase in comparable restaurant sales of \$1.2 million, or 2.4%, in the twelve weeks ended October 3, 2016 comprised primarily of a 0.5% decrease in transactions and product mix combined with a 2.9% increase in price.

Royalty fees. Royalty fees remained flat in the twelve weeks ended October 3, 2016 compared to the twelve weeks ended October 5, 2015.

Cost of sales. Cost of sales increased \$3.1 million in the twelve weeks ended October 3, 2016 compared to the twelve weeks ended October 5, 2015, due primarily to the increase in restaurant sales. As a percentage of restaurant sales, cost of sales decreased from 31.5% in the twelve weeks ended October 5, 2015 to 30.9% in the twelve weeks ended October 3, 2016. This decrease was primarily driven by lower costs in produce and paper products.

Labor. Labor increased by \$3.6 million in the twelve weeks ended October 3, 2016 compared to the twelve weeks ended October 5, 2015, due primarily to opening 36 new Company-owned restaurants. As a percentage of restaurant sales, labor increased from 28.2% in the twelve weeks ended October 5, 2015 to 29.0% in the twelve weeks ended October 3, 2016. The increase was primarily driven by an increase in wage rates and benefit costs as well as the dilutive effect on margins from our newest restaurants which, on average, initially operate at less than system-wide average sales volumes.

Store operating expenses. Store operating expenses increased by \$3.5 million in the twelve weeks ended October 3, 2016 compared to the twelve weeks ended October 5, 2015, due primarily to opening 36 new Company-owned restaurants. As a percentage of restaurant sales, store operating expense increased from 18.8% in the twelve weeks ended October 5, 2015 to 20.9% in the twelve weeks ended October 3, 2016. This increase was primarily attributable to the dilutive effect on margins from our newest restaurants which, on average, initially operate at less than system-wide average sales volumes as well as increased costs related to foundational in-store technology.

General and administrative expenses. General and administrative expenses decreased by \$0.1 million in the twelve weeks ended October 3, 2016 compared to the twelve weeks ended October 5, 2015. As a percentage of revenue, general and administrative expenses decreased from 11.3% in the twelve weeks ended October 5, 2015 to 9.4% in the twelve weeks ended October 3, 2016. The decrease is primarily driven by executive transition costs of \$0.3 million in the prior year and a decrease in our variable incentive compensation offset by increased corporate payroll and benefits costs associated with supporting an increased number of restaurants, incremental compliance costs as well as increased non-cash equity-based compensation due to headcount growth.

Depreciation. Depreciation increased by \$0.7 million in the twelve weeks ended October 3, 2016 compared to the twelve weeks ended October 5, 2015, due primarily to opening 36 new Company-owned restaurants. As a percentage of revenue, depreciation increased from 4.9% in the twelve weeks ended October 5, 2015 to 5.2% in the twelve weeks ended October 3, 2016.

Amortization. Amortization remained flat in the twelve weeks ended October 3, 2016 compared to the twelve weeks ended October 5, 2015.

Pre-opening costs. Pre-opening costs decreased by \$0.1 million in the twelve weeks ended October 3, 2016 compared to the twelve weeks ended October 5, 2015. As a percent of revenue, pre-opening costs decreased from 1.2% in the twelve weeks ended October 5, 2015 to 0.9% in the twelve weeks ended October 3, 2016 primarily due to timing of openings and improved cost management.

Casualty loss. During the twelve weeks ended October 5, 2015, we recognized a \$0.4 million write-off of long-lived assets associated with a restaurant in Columbia, South Carolina affected by extreme flooding resulting from Hurricane Joaquin. The restaurant reopened in the same location on May 12, 2016.

Interest expense. Interest expense increased by \$0.1 million in the twelve weeks ended October 3, 2016 compared to the twelve weeks ended October 5, 2015, due primarily to increased interest from deemed landlord financing.

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Provision for income taxes. Provision for income taxes decreased by \$1.6 million in the twelve weeks ended October 3, 2016 compared to the twelve weeks ended October 5, 2015. Our tax expense typically remains relatively constant as it primarily reflects the accrual of income tax expense related to a valuation allowance in connection with the tax amortization of the Company's goodwill that was not available to offset existing deferred tax assets. Due to the uncertain timing of the reversal of this temporary difference, it cannot be considered as a source of future taxable income for purposes of determining a valuation allowance; therefore the deferred tax liability cannot offset deferred tax assets. The comparison of our effective tax rate between periods is significantly impacted by the level of pre-tax income earned and projected for the year. Our historical fourth quarter results in negative pretax income, creating significant fluctuations in income tax expense and the resulting effective tax rate quarter over quarter and year over year.

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## Forty Weeks Ended October 3, 2016 compared to Forty Weeks Ended October 5, 2015

The following table presents selected consolidated comparative results of operations from our unaudited condensed consolidated financial statements for the forty weeks ended October 3, 2016 compared to the forty weeks ended October 5, 2015:

	Forty Weeks Ended			
	October 3, 2016	October 5, 2015	Increase / Dollars	(Decrease) Percentage
(Dollars in thousands)				
Consolidated Statement of Operations Data:				
Revenue:				
Restaurant sales	\$213,815	\$173,706	\$40,109	23.1 %
Royalty fees	165	160	5	3.1 %
Total revenue	213,980	173,866	40,114	23.1 %
Operating expenses:				
Restaurant operating costs (excluding depreciation and amortization):				
Cost of sales	64,764	54,716	10,048	18.4 %
Labor	61,612	48,686	12,926	26.5 %
Store operating expenses	42,534	32,890	9,644	29.3 %
General and administrative expenses	23,028	19,897	3,131	15.7 %
Depreciation	10,773	8,540	2,233	26.1 %
Amortization	1,240	1,262	(22)	(1.7) %
Pre-opening costs	1,906	2,174	(268)	(12.3) %
Casualty loss	—	351	(351)	(100.0) %
Loss from disposal of equipment	428	197	231	117.3 %
Total operating expenses	206,285	168,713	37,572	22.3 %
Income from operations	7,695	5,153	2,542	49.3 %
Other income and expenses:				
Interest expense, net	2,899	2,449	450	18.4 %
Other income	(67)	(51)	(16)	31.4 %
Total other income and expenses	2,832	2,398	434	18.1 %
Income before provision for income taxes	4,863	2,755	2,108	76.5 %
Provision for income taxes	2,559	4,199	(1,640)	(39.1) %
Net income (loss)	\$2,304	\$(1,444)	\$3,748	259.6 %

Restaurant sales. The following table summarizes the growth in restaurant sales from the forty weeks ended October 5, 2015 to the forty weeks ended October 3, 2016 (dollars in thousands):

	Net Sales
Restaurant sales for the forty weeks ended October 5, 2015	\$173,706
Incremental restaurant sales increase due to:	
Comparable restaurant sales	7,776
Restaurants not in comparable restaurant base	32,333
Restaurant sales for the forty weeks ended October 3, 2016	\$213,815

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Restaurant sales increased by \$40.1 million, or 23.1%, in the forty weeks ended October 3, 2016 compared to the forty weeks ended October 5, 2015. Restaurants not in the comparable restaurant base and other sales accounted for \$32.3 million of this increase. The balance of the growth was due to an increase in comparable restaurant sales of \$7.8 million, or 4.9%, in the forty weeks ended October 3, 2016 comprised primarily of a 2.2% increase in transactions and product mix combined with a 2.7% increase in price.

Royalty fees. Royalty fees remained flat in the forty weeks ended October 3, 2016 compared to the forty weeks ended October 5, 2015.

Cost of sales. Cost of sales increased \$10.0 million in the forty weeks ended October 3, 2016 compared to the forty weeks ended October 5, 2015, due primarily to the increase in restaurant sales. As a percentage of restaurant sales, cost of sales decreased from 31.5% in the forty weeks ended October 5, 2015 to 30.3% in the forty weeks ended October 3, 2016. This decrease was primarily driven by lower costs in poultry, produce and paper products.

Labor. Labor increased by \$12.9 million in the forty weeks ended October 3, 2016 compared to the forty weeks ended October 5, 2015, due primarily to opening 36 new Company-owned restaurants. As a percentage of restaurant sales, labor increased from 28.0% in the forty weeks ended October 5, 2015 to 28.8% in the forty weeks ended October 3, 2016. The increase was primarily driven by an increase in wage rates and benefit costs as well as the dilutive effect on margins from our newest restaurants which, on average, initially operate at less than system-wide average sales volumes.

Store operating expenses. Store operating expenses increased by \$9.6 million in the forty weeks ended October 3, 2016 compared to the forty weeks ended October 5, 2015, due primarily to opening 36 new Company-owned restaurants. As a percentage of restaurant sales, store operating expense increased from 18.9% in the forty weeks ended October 5, 2015 to 19.9% in the forty weeks ended October 3, 2016. This increase was primarily attributable to the dilutive effect on margins from our newest restaurants which, on average, initially operate at less than system-wide average sales volumes as well as increased costs related to foundational in-store technology.

General and administrative expenses. General and administrative expenses increased by \$3.1 million in the forty weeks ended October 3, 2016 compared to the forty weeks ended October 5, 2015. As a percentage of revenue, general and administrative expenses decreased from 11.4% in the forty weeks ended October 5, 2015 to 10.8% in the forty weeks ended October 3, 2016. The decrease is primarily driven by executive transition costs of \$0.9 million in the prior year and a decrease in our variable incentive compensation offset by increased corporate payroll and benefits costs associated with supporting an increased number of restaurants, incremental compliance costs as well as increased non-cash equity-based compensation due to headcount growth.

Depreciation. Depreciation increased by \$2.2 million in the forty weeks ended October 3, 2016 compared to the forty weeks ended October 5, 2015, due primarily to opening 36 new Company-owned restaurants. As a percentage of revenue, depreciation increased from 4.9% in the forty weeks ended October 5, 2015 to 5.0% in the forty weeks ended October 3, 2016.

Amortization. Amortization remained flat in the forty weeks ended October 3, 2016 compared to the forty weeks ended October 5, 2015.

Pre-opening costs. Pre-opening costs decreased by \$0.3 million in the forty weeks ended October 3, 2016 compared to the forty weeks ended October 5, 2015. As a percent of revenue, pre-opening costs decreased from 1.3% in the forty weeks ended October 5, 2015 to 0.9% in the forty weeks ended October 3, 2016 primarily due to timing of openings and improved cost management.

Casualty loss. During the forty weeks ended October 5, 2015, we recognized \$0.4 million write-off of long-lived assets associated with a restaurant in Columbia, South Carolina affected by extreme flooding resulting from Hurricane Joaquin. The restaurant reopened in the same location on May 12, 2016.

Interest expense. Interest expense increased by \$0.5 million in the forty weeks ended October 3, 2016 compared to the forty weeks ended October 5, 2015, due primarily to increased interest from deemed landlord financing.

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Provision for income taxes. Provision for income taxes decreased \$1.6 million for the forty weeks ended October 3, 2016 compared to the forty weeks ended October 5, 2015. Our tax expense typically remains relatively constant as it primarily reflects the accrual of income tax expense related to a valuation allowance in connection with the tax amortization of the Company's goodwill that was not available to offset existing deferred tax assets. Due to the uncertain timing of the reversal of this temporary difference, it cannot be considered as a source of future taxable income for purposes of determining a valuation allowance; therefore the deferred tax liability cannot offset deferred tax assets. The comparison of our effective tax rate between periods is significantly impacted by the level of pre-tax income earned and projected for the year. Our historical fourth quarter results in negative pretax income, creating significant fluctuations in income tax expense and the resulting effective tax rate quarter over quarter and year over year.

Adjusted EBITDA

EBITDA is defined as net income (loss) before interest, income taxes and depreciation and amortization.

We define Adjusted EBITDA as EBITDA plus gains and losses on asset disposals, pre-opening costs, casualty loss and executive transition costs. EBITDA and Adjusted EBITDA are intended as a supplemental measures of our performance that are not required by, or presented in accordance with, GAAP. We believe that EBITDA and Adjusted EBITDA provide useful information to management and investors regarding certain financial and business trends relating to our financial condition and operating results. Our management uses EBITDA and Adjusted EBITDA (i) as a factor in evaluating management's performance when determining incentive compensation and (ii) to evaluate the effectiveness of our business strategies.

We believe that the use of EBITDA and Adjusted EBITDA provides an additional tool for investors to use in evaluating ongoing operating results and trends and in comparing the Company's financial measures with other fast casual restaurants, which may present similar non-GAAP financial measures to investors. In addition, you should be aware when evaluating EBITDA and Adjusted EBITDA that in the future we may incur expenses similar to those excluded when calculating these measures. Our presentation of these measures should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items. Our computation of Adjusted EBITDA may not be comparable to other similarly titled measures computed by other companies, because all companies do not calculate Adjusted EBITDA in the same fashion.

Our management does not consider EBITDA or Adjusted EBITDA in isolation or as an alternative to financial measures determined in accordance with GAAP. The principal limitation of EBITDA and Adjusted EBITDA is that they exclude significant expenses and income that are required by GAAP to be recorded in the Company's financial statements. Some of these limitations are:

- Adjusted EBITDA does not reflect our cash expenditures, or future requirements, for capital expenditures or contractual commitments;

- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;

- Adjusted EBITDA does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debts;

although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;

- Adjusted EBITDA does not reflect the impact of certain cash charges resulting from matters we consider not to be indicative of our ongoing operations; and

- other companies in our industry may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure.

Because of these limitations, EBITDA and Adjusted EBITDA should not be considered in isolation or as a substitute for performance measures calculated in accordance with GAAP. We compensate for these limitations by relying primarily on our GAAP results and using EBITDA and Adjusted EBITDA only supplementally. You should review the reconciliation of net income to EBITDA and Adjusted EBITDA below and not rely on any single financial

measure to evaluate our business.

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The following table reconciles net income (loss) to EBITDA and Adjusted EBITDA:

	Twelve Weeks Ended		Forty Weeks Ended	
	October 3, 2016	October 5, 2015	October 3, 2016	October 5, 2015
	(Dollars in thousands)			
Adjusted EBITDA:				
Net income (loss), as reported	\$(293 )	\$(2,256 )	\$2,304	\$(1,444 )
Depreciation and amortization	3,856	3,136	12,013	9,802
Interest expense, net	916	767	2,899	2,449
Provision for income taxes	1,450	3,094	2,559	4,199
EBITDA	5,929	4,741	19,775	15,006
Asset disposals <sup>(1)</sup>	91	50	428	197
Pre-opening costs <sup>(2)</sup>	614	689	1,906	2,174
Casualty loss <sup>(3)</sup>	—	351	—	351
Executive transition costs <sup>(4)</sup>	—	319	—	868
Adjusted EBITDA	\$6,634	\$6,150	\$22,109	\$18,596

(1) Represents costs related to loss on disposal of equipment.

(2) Represents expenses directly associated with the opening of new restaurants that are incurred prior to opening, including pre-opening rent.

(3) Represents write-off of long-lived assets associated with a restaurant in Columbia, South Carolina damaged by a hurricane last year and reopened in the current year.

(4) Represents costs associated with our former CFO's departure pursuant to his employment and transition agreement and costs associated with our current CFO pursuant to executive recruiter costs and his employment agreement.

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## Liquidity and Capital Resources

## Potential Impacts of Market Conditions on Capital Resources

We have continued to experience increases in comparable restaurant sales, operating cash flows and restaurant contribution; however, the restaurant industry continues to be highly competitive, and uncertainty exists as to the sustainability of these favorable trends. We have continued to implement various cost savings initiatives, including savings in our food costs through waste reduction and efficiency initiatives in our supply chain and labor costs. We have developed new menu items to appeal to consumers and used marketing campaigns to promote these items. We believe that cash and cash equivalents, available borrowings and expected cash flow from operations are adequate to fund our operating lease obligations, capital expenditures and working capital obligations for the next 12 months. However, our ability to continue to meet these requirements and obligations will depend on, among other things, our ability to achieve anticipated levels of revenue and cash flow from operations and our ability to manage costs and working capital successfully.

## Summary of Cash Flows

Following the IPO, our primary sources of liquidity and cash flows have been operating cash flows and the remaining net proceeds from the IPO. We are using these sources to fund capital expenditures for new Company-owned restaurant openings, reinvest in our existing restaurants, repurchase restaurants from our franchisees, invest in infrastructure and information technology and maintain working capital. Our working capital position benefits from the fact that we generally collect cash from sales to customers the same day, or in the case of credit or debit card transactions, within several days of the related sale, and we typically have at least 20 days to pay our vendors.

Forty Weeks Ended  
October 3, October 5,  
2016      2015

(Dollars in  
thousands)

## Consolidated Statement of Cash Flows Data:

Net cash provided by operating activities	\$22,056	\$19,949
Net cash used in investing activities	(32,905 )	(30,597 )
Net cash provided by financing activities	1,220	1,651

## Cash Flows Provided by Operating Activities

Net cash provided by operating activities increased to \$22.1 million for the forty weeks ended October 3, 2016 from \$19.9 million for the forty weeks ended October 5, 2015. Net cash provided by operating activities consists primarily of net income, adjusted for non-cash expenses such as depreciation and amortization, and the net change in operating assets and liabilities. Net cash provided by operating activities for the forty weeks ended October 3, 2016 consisted primarily of net income adjusted for non-cash expenses and an increase in deferred rent related to new store openings.

## Cash Flows Used in Investing Activities

Net cash used in investing activities increased to \$32.9 million for the forty weeks ended October 3, 2016 from \$30.6 million for the forty weeks ended October 5, 2015. The increase was primarily due to purchases of property and equipment offset by proceeds from a sale-leaseback transaction in the forty weeks ended October 3, 2016 of \$2.1 million.

## Cash Flows Provided by Financing Activities

Cash flows provided by financing activities decreased to \$1.2 million for the forty weeks ended October 3, 2016 from \$1.7 million for the forty weeks ended October 5, 2015, primarily due to less proceeds from the exercise of stock options and deemed landlord financing.

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Credit Facility

On February 6, 2015, we entered into the 2015 Credit Facility with Wells Fargo Bank, National Association. The 2015 Credit Facility consists of a revolving loan commitment in the aggregate amount of \$20.0 million, together with an incremental revolving credit commitment up to an aggregate amount of \$30.0 million. The 2015 Credit Facility has a five year term and matures on February 6, 2020. As of October 3, 2016, we had no indebtedness under the 2015 Credit Facility.

Off-Balance Sheet Arrangements

As of October 3, 2016, we did not have any off-balance sheet arrangements.

Critical Accounting Policies and Estimates

Our discussion and analysis of operating results and financial condition are based upon our financial statements. The preparation of our financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures of contingent assets and liabilities. We base our estimates on past experience and other assumptions that we believe are reasonable under the circumstances, and we evaluate these estimates on an ongoing basis. Our critical accounting policies are those that materially affect our financial statements and involve difficult, subjective or complex judgments by management. Although these estimates are based on management's best knowledge of current events and actions that may impact us in the future, actual results may be materially different from the estimates.

We believe our critical accounting policies are affected by significant judgments and estimates used in the preparation of our consolidated financial statements and that the judgments and estimates are reasonable. Our critical accounting policies and estimates are described in our annual consolidated financial statements and the related notes in our 2015 Form 10-K.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes to our exposure to market risk previously disclosed in Part II, Item 7A of our 2015 Form 10-K for the year ended December 28, 2015.

Item 4. Controls and Procedures

As of October 3, 2016, the Company's management carried out an evaluation with the participation of Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this report, our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, were effective to provide reasonable assurance that the information we are required to file under the Exchange Act is recorded and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

There have been no changes in internal control over financial reporting during the quarter ended October 3, 2016 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



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Part II - Other Information

Item 1. Legal Proceedings

Refer to Note 8, Commitments and Contingencies, of the Notes to the Unaudited Condensed Consolidated Financial Statements.

Item 1A. Risk Factors

There have been no material changes from the risk factors previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 28, 2015.

Item 2. Unregistered Sales of Equity and Use of Proceeds

None.

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

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Item 6. Exhibits

Exhibit Index

Exhibit Number	Description of Exhibit
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

\* This certification is deemed not filed for purposes of section 18 of the Exchange Act, or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act.

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SIGNATURES

Pursuant to the requirements of the Securities Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 14, 2016

ZOE'S KITCHEN, INC.

By: /s/ Kevin Miles

Name: Kevin Miles

Title: President and Chief Executive Officer

By: /s/ Sunil Doshi

Name: Sunil Doshi

Title: Chief Financial Officer